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UNITED STATES DISTRICT COURT

DISTRICT OF ARIZONA

HEIN HETTINGA AND ELLEN HETTINGA d/b/a SARAH FARMS,

Plaintiffs,

v.

THOMAS J. VILSACK, in his capacity as Secretary of the UNITED STATES DEPARTMENT OF AGRICULTURE,

Defendant.

09-CV-00204-PHX-JWS

DEFENDANT'S MEMORANDUM IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

SUMMARY OF ARGUMENT

Plaintiffs, Hein and Ellen Hettinga d/b/a Sarah Farms ("Hettingas") seek a declaratory judgment that the Secretary of the U.S. Department of Agriculture ("Secretary") erred as a matter of law in imposing minimum price requirements upon them for milk sold during the month of April 2006, resulting in an assessment of $324.211.60 by the Milk Market Administrator ("Administrator"). Plaintiffs' complaint alleges that the Secretary misinterpreted a federal regulation, the Arizona-Las Vegas milk marketing order, which defines who qualifies for the "producer-handler" exception to the regulation. Compl. ¶ 33. On February 24, 2006, the Administrator issued a final rule, effective on April 1, 2006, that limited the definition of producer-handlers operating in the Arizona-Las Vegas and Pacific Northwest milk marketing areas. Specifically, the definition was limited to those who operate a dairy farm and distributing plant and whose in-area route distributions of class 1 milk do not exceed 3,000,000 pounds per month. 71 Fed. Reg. 9430 (Feb. 24, 2006). As they freely acknowledge, the Hettingas' in-area route distributions of class I milk exceeded 3,000,000 pounds at that time and would continue to do so in April 2006. Thus, according to the plain language of the regulation, in April 2006, they were not eligible for the regulatory exemption afforded producer-handlers and were required to pay the resulting assessment. Furthermore, even if there is some ambiguity in the regulation, the Secretary's interpretation that plaintiffs never qualified as a producer-handler under the new regulation, and thus were required to pay the assessment as of April 1, 2006, the effective day of the regulation, is entitled to deference. Because there is no genuine dispute as to any material fact and, even viewing the exhibits and testimony in the light most favorable to the Hettingas, their claim fails as a matter of law, and judgment should be entered in favor of the Secretary.

STATUTORY AND REGULATORY BACKGROUND

I. The Federal Regulation of Milk

Through the Agricultural Marketing Agreement Act of 1937 as amended, see 7 U.S.C. § 601 et seq. (the "AMAA"), Congress empowered the Secretary of Agriculture to regulate

persons who handle agricultural commodities, including milk products. See id. § 608c(1)-(2). Congress authorized the regulation of such persons, known as "handlers," through agricultural marketing orders to further several policy objectives, including establishing and maintaining orderly marketing conditions for agricultural commodities, see id. § 602(1), protecting consumers of agricultural commodities, see id. § 602(2), as well as avoiding unreasonable fluctuations in supplies and prices by maintaining an orderly supply of agricultural products throughout the seasons, see id. § 602(4).

With regard to milk, the AMAA authorizes the Secretary of Agriculture to establish milk marketing orders to regulate different geographic regions of the country. See id. §§ 608c(1), (5). This authority includes the ability to guarantee dairy farmers (referred to as "producers") a minimum uniform price for milk sold to handlers, regardless of the milk's ultimate use. Id. §§ 608c(5)(A)-(c). Pursuant to the AMAA, the Secretary of Agriculture has issued several milk marketing orders for many geographic regions of the United States, including Order 131, which governs the Arizona geographic region. See, e.g., 7 C.F.R. §§ 1131.1 -.86 (providing regulations specific to Order 131).

On the handler side, a 'pool' or 'settlement fund' is created to take into account the end use of milk purchased at the blend price. See 7 C.F.R. § 1000.70 (providing for the settlement fund). Handlers pay into the settlement fund to the extent that the average end-use value of their milk products exceeds the blend price. See Lehigh Valley Farmers v. Block, 829 F.2d 409, 412 (3d Cir. 1987); Schepps Dairy, Inc. v. Bergland, 628 F.2d 11, 15 (D.C. Cir. 1979); see, e.g., 7 C.F.R. § 1131.71 (providing for handler payments into the settlement fund for Order 131). Handlers whose average end-use value of their milk products is below the blend price receive payments from the settlement fund. See Lehigh Valley, 829 F.2d at 412; Schepps Dairy, 628 F.2d at 15; see, e.g., 7 C.F.R. § 1131.72 (providing for payments to handlers from the settlement fund for Order 131). The net effect of these payments is that "each handler pays for his milk at the price he would have paid had it been earmarked at the outset for the use to which it was ultimately put." Lehigh Valley Coop. Farmers, Inc. v.

United States, 370 U.S. 76, 81 (1962); see also 7 U.S.C. § 608c(5)(c) (requiring that "the total sums paid by each handler shall equal the value of milk purchased by him at the prices fixed . . ."); Lamers Dairy Inc. v. USDA, 379 F.3d 466, 470 (7th Cir. 2004).

II. Exceptions to the Pooling and Pricing Obligations

Prior to April 1, 2006, there were two loopholes that would allow even the largest handlers to avoid the pooling and pricing obligations. First, when a handler located in a federally regulated marketing order sold milk into an area subject to state regulation, those sales were exempt from federal (and state) pool payment obligations. Second, where a handler's operations were so thoroughly integrated with the production side that the entire business – from cow to consumer – did not rely on federal minimum price guarantees, it was exempt from the pooling and pricing obligations. See Edaleen Dairy, LLC v. Johanns, 467 F.3d 778, 780 (D.C. Cir. 2006). Historically, the entities qualifying for this so-called producer-handler exception were small family businesses, and their use of the exception did not disrupt orderly milk market conditions. See id.; Stew Leonard's v. Glickman, 199 F.R.D. 48, 50 (D. Conn. 2001). In recent years, however, the allure of the competitive advantage from the producer-handler exception (not having to make payments to the settlement fund) has motivated entities with large-scale dairy operations to exploit the exception. See Edaleen Dairy, 467 F.3d at 780.

III. The February 2006 Amendments to USDA Regulations for Order 131

In February 2006, the Secretary of Agriculture redefined the producer-handler exception for Order 131 so that large producer-handlers are no longer exempt from the Order's pooling and pricing requirements. See *Milk in the Pacific Northwest and Arizona-Las Vegas Marketing Areas; Order Amending the Orders*, 71 Fed. Reg. 9430 (Feb. 24, 2006).[1] Under the amended regulatory definition, handlers with in-area monthly milk

[1] Congress later incorporated this new definition in the Milk Regulatory Equity Act, which amended the AMAA by limiting the exceptions to the pooling and pricing obligations. See

distributions of over three million pounds no longer qualify as exempt producer-handlers. 71 Fed. Reg. at 9433, Part 3 (codified at 7 C.F.R. § 1131.10). As a result, large producer-handlers in Arizona are now subject to the same pooling and pricing requirements that apply to all handlers. See 71 Fed. Reg. at 9430.

Before implementing the February 2006 rule, USDA issued a proposed rule, heard testimony, and made findings regarding the need and appropriateness of amending the producer-handler exception for Order 131. See *Milk in the Pacific Northwest and Arizona-Las Vegas Marketing Areas; Final Decision on Proposed Amendments to Marketing Agreement and to Orders*, 70 Fed. Reg. 74166-91 (Dec. 14, 2005). As a result of that process, USDA concluded that contrary to the AMAA's goal of achieving orderly milk markets, an uncapped producer-handler exception in the Arizona region was contributing to significant market instability. See 70 Fed. Reg. at 74185-86; see also id. at 74188 ("This decision finds that disorderly marketing conditions exist in the Pacific Northwest and the Arizona-Las Vegas marketing areas.").[2]

In addition to these findings on the disruptive effects of an uncapped producer-handler exception, USDA also concluded that a central rationale underlying the producer-handler exception no longer applied to the large producer-handlers. A justification for exempting producer-handlers from the pooling and pricing requirements was that they bore the burden of disposing of their surplus milk – milk that they processed, but could not sell as fluid milk. But, that rationale ceases to exist for large producer-handlers because by not having to pay into the settlement fund, they can price their milk so that all of it can be sold as highly

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Pub. L. No. 109-215, 120 Stat 328 (Apr. 11, 2006) (codified at 7 U.S.C. § 608c(5)(M)-(N)). In particular, subsection (N) regulates milk handlers in Order 131. Under subsection (N), handlers (including producer-handlers) with a monthly disposition of over three million pounds of Class I milk products from their own farms are subject to the minimum pooling and pricing requirements. See 7 U.S.C. § 608c(5)(N).

[2] USDA concluded that the evidence before it would have supported a decision to phase out the producer-handler exception at an even lower monthly milk volume – 150,000 pounds – one-twentieth of the current three-million pound cap. See 70 Fed. Reg. at 74186.

profitable fluid milk. See 70 Fed. Reg. at 74187. Thus, USDA found that the competitive advantage from the producer-handler exception is so great that it allows large producer-handlers to avoid the risks traditionally associated with producer-handler status. Id.

FACTS RELEVANT TO PLAINTIFFS' CLAIMS

I. The Hettingas' Operation of Sarah Farms

Plaintiffs Hein and Ellen Hettinga own and operate Sarah Farms, a large dairy business in Arizona. Defendant's Statement of Facts ("DF") at ¶ 1 (Judicial Officer Decision and Order, Administrative Record ("AR") Tab No. 38 at 8).[3] Sarah Farms is an integrated producer and handler that produces milk on farms owned by the Hettingas and processes that raw milk into bottled milk for sale directly to consumers, milk dealers, and retailers. DF at ¶ 2. From 1994 until April 1, 2006, Sarah Farms qualified as a "producer-handler" of milk and was exempted from complying with the pooling and pricing obligations of the federal milk marketing order that covered Arizona. DF at ¶ 3; see JO Decision and Order, AR Tab No. 38 at 9. However, as described above, the regulations that became effective April 1, 2006 subjected producer-handlers operating in the Arizona-Las Vegas and Pacific Northwest milk marketing areas to the pricing and pooling provisions of their respective milk marketing orders if they had in-area route distributions of class I milk in excess of 3,000,000 pounds per month. DF at ¶ 4; see 71 Fed. Reg. 9430 (Feb. 24, 2006). As the Hettingas readily acknowledge, Sarah Farms sells more than 3,000,000 pounds per month in the geographic area covered by Order 131. DF at ¶ 5; see also Plaintiffs' Statement of Material Facts ("PF") ¶¶ 13, 19; Compl. ¶ 19. Following adoption of the final rule, the Administrator imposed minimum price requirements upon the Hettingas for milk sold during the month of April 2006, resulting in a pool payment of $324.211.60. AR Tab No. 38 at 9.

[3] Defendant filed the Administrative Record (*In re: Hettinga d/b/a Sarah Farms*, AMA-M Docket No. 08-0071) with this Court on June 1, 2009. See Doc. No. 12. References to documents in the AR are hereinafter referred to by Tab number (Tab No.) and page number.

II. Prior Administrative Proceedings

On March 7, 2008, the Hettingas instituted an administrative proceeding under the AMAA, seeking a determination that the Market Administrator misinterpreted and misapplied the federal order regulating the handling of "Milk in the Arizona-Las Vegas Marketing Area" (7 C.F.R. pt. 1131 (April 1, 2006)) by imposing minimum price regulations upon the Hettingas for the month of April 2006. DF at ¶ 7; AR Tab No. 1. On November 17, 2008, the Administrative Law Judge (ALJ) issued a Decision and Order in which the ALJ concluded that the Market Administrator's imposition of minimum price regulations upon the Hettingas for the month of April 2006 "was appropriate and in accordance with law based upon the revisions to Milk Marketing Order;" the Judge therefore denied the relief and dismissed their claim with prejudice. DF at ¶ 8; AR Tab No. 32 at 7-8. The rationale behind this decision was that the new regulation "changed the definition of producer-handler in such a way as to make the [Hettingas] no longer eligible for the regulatory exemption afforded producer-handlers." Id. at 5. On January 15, 2009, this decision was affirmed by the Judicial Officer for precisely the same reason (i.e., the Hettingas' in-area route distribution exceeded 3,000,000 pounds for April 2006 which precluded them from qualifying as a producer-handler). See DF at ¶ 9; A.R. Tab No. 38 at 12, 15.

STANDARD OF REVIEW

Summary judgment is appropriate when "there is no genuine issue as to any material fact and . . . the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). Review of agency action under the Administrative Procedure Act can usually be resolved through summary judgment, because the reviewing court does not engage in factfinding of its own; the Court's only task is to determine whether the agency's action was permissible on the basis of the governing law and the factual record compiled by the agency. See Fla. Power & Light Co. v. Lorion, 470 U.S. 729, 743–44 (1985) ("The task of the reviewing court is to apply the appropriate APA standard of review to the agency

decision based on the record the agency presents to the reviewing court." (citation omitted)).

Judicial review of the actions of an administrative agency under the Administrative Procedure Act is highly deferential. A court reviewing an agency's action under the APA may not "substitute its judgment for that of the agency" merely because the court disagrees with what the agency has done. Public Citizen v. Nuclear Regulatory Comm'n, 573 F.3d 916, 923 (9th Cir. 2009) (internal quotations and citation omitted). Rather, a court may set aside agency action only if the action is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A).

Here, Plaintiffs are challenging the USDA's interpretation and application of its own regulations. A reviewing court must "give substantial deference to an agency's interpretation of its own regulations." Thomas Jefferson Univ. v. Shalala, 512 U.S. 504, 512 (1994). The Supreme Court has explained:

> Our task is not to decide which among several competing interpretations best serves the regulatory purpose. Rather, the agency's interpretation must be given "'controlling weight unless it is plainly erroneous or inconsistent with the regulation.'" In other words, we must defer to the Secretary's interpretation unless an "alternative reading is compelled by the regulation's plain language or by other indications of the Secretary's intent at the time of the regulation's promulgation." This broad deference is all the more warranted when . . . the regulation concerns "a complex and highly technical regulatory program," in which the identification and classification of relevant "criteria necessarily require significant expertise and entail the exercise of judgment grounded in policy concerns."

Id. (citations omitted); see also Auer v. Robbins, 519 U.S. 452, 461 (1997). Review of the Secretary's decision is limited to whether the decision is "supported by substantial evidence and is in accordance with law." Lehigh Valley Farms, 829 F.2d at 412; see also Lansing Dairy, Inc. v. Espy, 39 F.3d 1339, 1355 (6th Cir. 1994).

ARGUMENT

I. Plaintiffs Were Not a "Producer-Handler" under the Plain Language of the Regulation That Became Effective April 1, 2006

Plaintiffs concede, as they must, that because they distribute more than 3 million

pounds of milk per month in the Arizona-Las Vegas milk marketing area, they "ceased to be eligible for the producer-handler exemption" when the new regulations came into effect on April 1, 2006. PF ¶ 16. They nevertheless contend that they are entitled to a refund of the amounts they paid to the Milk Market Administrator's Office for the month of April 2006 because, in their view, the Administrator was required under 7 C.F.R. § 1131.10(c) to provide a month's notice of the "cancellation" of their status as a producer-handler.

This argument cannot be reconciled with the plain language of the new regulations. The Hettingas could only qualify as a producer-handler if they operated a dairy farm and a distributing plant "from which there is route distribution within the marketing area during the month not to exceed 3 million pounds" ***and*** if the marketing administrator designated them as a producer-handler. 7 C.F.R. § 1131.10. If, as the Hettingas concede, they failed to meet the first part of this definition, the second part (whether or not they were designated and/or whether this designation was cancelled) is simply irrelevant. As the ALJ succinctly explained, the February 24, 2006 regulation "changed the definition of producer-handler in such a way as to make the [Hettingas] no longer eligible for the regulatory exemption afforded producer-handlers." AR Tab 32 at 5 (ALJ Decision and Order); see also Tab 38 at 12 (Judicial Officer Decision and Order agreeing with the ALJ's interpretation).

II. Plaintiffs' Cause of Action Should Also Be Rejected Because The Secretary Could Not Cancel a Producer-Handler Designation Which Plaintiffs Never Applied For and Which Never Existed

A. The Language of the Cancellation Provision is Irrelevant to this Dispute Because Plaintiffs Were Never Designated a Producer-Handler Under the New Regulations.

Plaintiffs assert that the "plain language" of 7 C.F.R. § 1131.10(c) somehow required the Department of Agriculture to affirmatively "cancel" their purported "status" as a producer-handler exempt from pooling and pricing obligations. Pl. Mem. at 7-9. In support of this proposition, they state that "[i]f someone had producer-handler status, then

the only way to terminate that status is by cancellation." Id. at 8. However, as the Judicial Officer explained:

> The Administrator amended the definition of the term "producer-handler" in the Arizona-Las Vegas Milk Marketing Order to include provisions for the market administrator's designation of persons as producer-handlers and cancellation of the producer-handler designation. The market administrator never designated the Hettingas as a producer-handler under the April 1, 2006 definition of "producer-handler." The Arizona-Las Vegas Milk Marketing Order provides that the designation of producer-handler shall be cancelled by the market administrator under certain circumstances (7 C.F.R. § 1131.10(c)(2007)). Logically, the market administrator cannot cancel a designation that does not exist. Therefore, as the Hettingas were never designated as a producer-handler under the April 1, 2006, definition of "producer-handler," the ALJ correctly concluded that the market administrator could not cancel the producer-handler designation of the Hettingas.

AR Tab 38 at 11-12. The simple fact is that Plaintiffs never were (and certainly never were designated as) a producer-handler under the new regulations that became effective on April 1, 2006. Thus, there was nothing for the Administrator to cancel, and the cancellation procedures therefore did not apply.

This conclusion finds further support in the language of the cancellation provision itself. It states that the "designation as a producer-handler shall be canceled upon determination by the market administrator that any of the requirements *of paragraph (a)(1) through (5) of this section* are not continuing to be met, or under any of the conditions *described in paragraphs (c)(1), (2) or (3) of this section*." 7 C.F.R. § 1131.10(c) (emphasis added). The conditions and requirements referred to do not even relate to the threshold definition of an exempt producer-handler, set forth in the preamble of 7 C.F.R. § 1131.10, as a person with monthly in area distributions that do not exceed 3 million pounds. They are *additional* requirements that a person must meet in order to obtain or maintain a designation as producer-handler exempt from the pooling and pricing obligations. This dispute had nothing to do with whether Plaintiffs satisfied the requirements of paragraph (a)(1) through (5) or the conditions set forth paragraphs (c)(1), (2) or (3) of the regulations. Again, the cancellation paragraph simply does not apply. Plaintiffs were simply not an exempt producer-handler in April 2006, as the regulations

define that term.[4]

B. Plaintiffs' Fixation on the Distinction between "Status" and "Designation" Is Also Not Germane to this Court's Determination

Plaintiffs allege that the Administrative Law Judge and Judicial Officer erred by concluding that § 1131.10(c) only applies to cancellation of the "designation" of producer-handler. Pl. Mem. at 11-14. This misapprehends both opinions. The ALJ explained that the Hettingas had failed to apply for and the market administrator did not "designate[]" them as a "producer-handler." See AR Tab 32 at 7. Essentially, the ALJ was saying the Hettingas had failed to meet the second criterion of the preamble of the Arizona Milk Marketing Order that went into effect on April 1, 2006. See AR Tab 40, Exhibit RX-8. The JO opinion affirmed the ALJ's conclusion and explained:

> The purported imprecision of United States Department of Agriculture employees when using the terms "designation" and "status" is not relevant to the disposition of the instant proceeding. The final rule, which amended the definition the term "producer-handler," requires that in order for a person to be a "producer-handler," the market administrator must designate that person as a producer-handler after determining that all of the requirements of 7 C.F.R. § 1131.10 have been met. The Hettingas were never designated by the market administrator as a producer-handler. The purported imprecise language used by United States Department of

[4] Plaintiffs cite In re H.P. Hood, 64 Agric. Dec. 1282, 2005 WL 6231897 (U.S.D.A. Oct. 26, 2005), see Pl. Mem. at 10-11, for the proposition that an agency interpretation "directly contrary" to a regulation is not entitled to deference. This idea – that when there is no ambiguity in a regulation and an agency takes an action which directly contravenes the language of the regulation – is not earth-shattering, see Thomas Jefferson Univ., 512 U.S. at 512, but it does not support plaintiffs' proposed interpretation of the regulation. The initial requirement that in-route distribution is "not to exceed 3 million pounds" to qualify as a producer-handler as of April 1, 2006 is clear and unambiguous. Ironically, only if the Secretary had ordered the relief plaintiffs' seek (i.e., that they be deemed a producer-handler for the month of April 2006, even though they do not meet the clear regulatory definition in effect during that month, and then have that designation cancelled, with cancellation effective the following month), would the Secretary arguably have violated the plain language of its regulations. In any event, even if the Court were to find the regulations ambiguous, the Secretary's reasonable interpretation would be entitled to deference. See id. ("agency's interpretation must be given 'controlling weight unless it is plainly erroneous or inconsistent with the regulation.'") (internal citations omitted); Department of Health & Human Services v. Chater, 163 F.3d 1129, 1133 (9th Cir. 1998) ("[W]e must give substantial deference to an agency's interpretation of its own regulations because its expertise makes it well-suited to interpret the language.").

> Agriculture employees does not change the fact that, as a matter of law, on and after April 1, 2006, the Hettingas were not a producer-handler under the Arizona-Las Vegas Milk Marketing Order.

AR Tab 38 at 13-14. As the Judicial Officer rightly pointed out, it is ultimately irrelevant whether plaintiffs had producer-handler "status" prior to April 1, 2006. The second criterion for qualifying for the producer-handler exemption under the Arizona-Las Vegas Milk Marketing Order that went into effect on April 1, 2006 was that the market administrator designate the producer-handler after determining that all of the requirements had been met. See AR Tab 40, Exhibit RX-8. As they readily admit, the Hettingas never applied to or were designated by the market administrator as a producer-handler after April 1, 2006. Even had they applied, it would not have mattered because the evidence before the ALJ and JO clearly established that their Class I route disposition per month was substantially greater than 3 million pounds, see AR Tab 24 at 2, so as of April 1, 2006, the Hettingas were not a "producer-handler." Hence, the milk administrator's imposition of the pooling and pricing requirements for milk sold during the month of April 2006 was lawful under the Secretary's regulations.

CONCLUSION

For the foregoing reasons, the Court should grant summary judgment in favor of Thomas J. Vilsack, Secretary of the U.S. Department of Agriculture and dismiss Plaintiffs' claims in their entirety.

Dated: October 8, 2009

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on October 8, 2009, I caused a copy of the foregoing Notice of Appearance to be electronically transmitted to the Clerk's Office using the CM/ECF System for filing and transmittal of a Notice of Electronic Filing to the following CM/ECF registrants:

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